

In general, the purchase of tangible personal property at retail for use or consumption in this State is subject to Illinois Use Tax. See 35 ILCS 105/2 and 3. (This is a GIL.)

October 23, 2003

Dear Xxxxx:

This letter is in response to your letter dated February 21, 2003. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), which can be found on the Department's website at www.revenue.state.il.us/Laws/regs/part1200/.

In your letter, you have stated and made inquiry as follows:

AAA on behalf of our client ('Company'), respectfully requests informal written advice from your state, Illinois, with respect to certain mail order gift transactions made pursuant to Company's normal business operations.

Some states have ruled that a donor of a gift, which is placed in the mail outside the state, relinquishes possession and control at the point from where the gift is sent. Accordingly, there is no taxable use of the gifted property by the donor in the destination state. Also, since by definition the gift recipient does not provide consideration to the donor for the gift, there is no measure for use tax attributable to the recipient.

On the behalf of our client, we respectfully request that Illinois respond as to the proper sales and use tax treatment of the transactions outlined below.

1. Facts

Company is a mail order/Internet gift company specializing in the sales of food or confection baskets/ensembles (packages often containing a significant portion of taxable items), flower baskets, and other gift items. A typical customer would include an individual who sends gifts to friends and relatives during the holiday season. Another typical customer would include, for example, a professional services firm such as a brokerage house, law firm, or accounting firm, who sends gifts to clients.

Through its mail order/Internet business, Company sends its products to recipients located throughout the United States. Company also has an affiliated corporate entity that operates retail stores. Since the retail stores support the mail order/Internet business, Company is registered and collects tax in all states where it has affiliated stores.

In a typical mail order/Internet transaction, a person ('the Purchaser') will place an order with Company and instruct Company to send the gift to a recipient ('the Recipient'). For ordering and billing purposes, Company requires the name, address, credit card number, and other information from the Purchaser. For delivery purposes, Company will receive from the Purchaser the name and address of the Recipient. The Company offers to send a greeting message from the Purchaser to the Recipient to be delivered with the product. Common messages include 'Happy New Year' and 'Best Wishes.' In most instances the Recipient will choose to send a greeting message with the product. Company will ship the product by mail or common carrier to the Recipient from a Company or drop shipper warehouse ('Warehouse') location. For purposes of this request, assume that the product is a taxable item in Illinois.

2. Request

Based on the facts above, Company requests written advice as to the following specific issues:

- 1.) Does Company have an Illinois sales or use tax collection responsibility for the transactions described in the following scenarios:
 - a. Purchaser, Recipient and Warehouse all located within Illinois.
 - b. Purchaser and Warehouse are located within Illinois, Recipient is not.
 - c. Purchaser and Recipient are located within Illinois, Warehouse is not.
 - d. Purchaser is located within Illinois, Recipient and Warehouse are not.
 - e. Purchaser is located outside of Illinois, Recipient and Warehouse are within Illinois.
 - f. Purchaser and Warehouse are located outside of Illinois, Recipient is within Illinois.
- 2.) If, under any of the scenarios posed above, Company does not have a sales or use tax collection responsibility because of the 'gift' nature of the transaction, does the fact that the Purchaser and the Recipient are different people at different addresses, coupled with the gift nature of Company's business, provide sufficient evidence that the transaction is a gift?

3. Analysis

The tax treatment of the various scenarios addressed above requires a framework from which to evaluate the tax implications. First, it must be emphasized that the sale transaction (or contract of sale) is between the Company and the Purchaser (i.e., donor). The delivery of the property to the Recipient is a 'gift' because the transfer to the Recipient is without consideration. There are no contractual obligations between the Recipient and either the Company or the Purchaser. The Recipient has no contractual rights under the contract. Furthermore, as discussed below, the Purchaser does not exercise any right or control over the gifted property once the property is provided to the common carrier for shipment.

Second, whenever a gift travels from a Warehouse located in one state to a Recipient located in another, the sale is an interstate sale, i.e. the seller is obligated under the contract to deliver the gifted property to a common carrier for delivery to an address in a

different state as designated by the Purchaser. As an interstate sales transaction, there is no taxable sale in the shipped-from state, i.e., the state of origin.

Finally, although the Recipient exercises ownership and control, the Recipient is not subject to use tax because no consideration was given for the gifted property. Accordingly, there is no measure of taxable purchase price for the Recipient.

Most states have not specifically addressed the issues of interstate gifts outlined above. However, California has specifically ruled that use tax does not apply to gifts sent to California recipients from locations outside the state. A published California sales and use tax annotation states that the deposit of a gift in the mail outside of California causes title to that property to pass to the California recipient at that time, and the purchaser is not subject to California use tax. *California Sales and Use Tax Annotation 280.0360*. See also *California Sales and Use Tax Annotation 325.0485*. Another annotation states that where a gift is purchased and the purchaser directs the vendor to ship to an out-of-state recipient, the sale occurs in interstate commerce and is thus not subject to California sales or use tax. *California Sales and Use Tax Annotation 280.0620*. The California Court of Appeal affirmed this logic in concluding that a use occurs where the gift is made, which is where the donor relinquishes possession. *Yamaha Corp. of America v. SBE, Ca. Ct. App. 2d. Dist. (1999), 73 Cal. App. 4th 338; 86 Cal Rptr 2d 32, Dkt. No.B095911, 6-29-99, on remand from Yamaha Corp. of America v. SBE (1998), 19 Cal 4th 1 960 P2d 1031, 78Cal Rptr 2d 1, which reversed and remanded Yamaha Corp. of America v. SBE (1997) 61 Cal. Rptr. 2d 2.*

4. Proposed Conclusions

Based on the above analysis, we propose the following conclusion to the scenarios posed above:

1(a) Yes. The transaction is subject to Illinois sales tax because the transaction is conducted completely within Illinois.

1(b) No. The transaction is not subject to Illinois sales or use tax because the sale is a sale in interstate commerce.

1(c) No. Consistent with the California conclusions above, title to the property would pass outside Illinois when the Warehouse delivers the property to the common carrier. Therefore, no sales tax would apply because the sale would not take place in Illinois. Use tax would not apply because the Purchaser does not exercise any ownership or control of the item in Illinois; rather, the Purchaser relinquished all ownership and control over the property outside Illinois. The Recipient is not subject to use tax because no consideration was provided for the property.

1(d) No. The transaction is not subject to Illinois sales or use tax because the property never enters the state.

1(e) Yes. The transaction is subject to Illinois sales tax because Recipient and Warehouse are in Illinois, accordingly the property never leaves Illinois.

1(f) No. Same as 1(c) above.

2. Yes. Given the nature of Company's business, the fact that the Purchaser and Recipient are different people at different addresses should be sufficient evidence to support a finding that a gift of the property has been made from Purchaser to Recipient. It is rare for customers to buy a food and non-food combination basket for themselves. If items are purchased for the buyer's own use, the buyer will use the buyer's name and address for delivery. Other evidence that the transfer is a gift is the fact that most of the gift items include a greeting message from the Purchaser to the Recipient making the gift. Considering the necessary practicalities of the Company's business operations and the need for predictability and simplicity in tax administration, we believe that the state should find reasonable support for concluding a gift transaction under the facts as stated.

5. Summary

The issues and scenarios outlined above reflect the actual facts of our client. We have proposed conclusions to these scenarios based on the conclusions from other states. This is an important customer relations and business issue for our client. As a result, we respectfully request this written advice so that our client can accurately comply with the reporting requirements of Illinois.

Thank you for your consideration of this matter. Should you have any questions, please feel free to contact me.

For your general information, please see the enclosed copy of Sec. 270.115 of the Home Rule Municipal Retailers' Occupation Tax for guidance concerning jurisdictional questions. In general, the imposition of the various sales tax related local taxes in Illinois are triggered when "selling" occurs in a jurisdiction imposing a tax. The Department's opinion is that the most important element of selling is the seller's acceptance of the purchase order. Consequently, if a purchase order is accepted in a jurisdiction that imposes a local tax, that tax will be incurred.

The tax rate is fixed by the location of the seller, not the delivery location. The fact that the item being sold is shipped from out-of-State or from another Illinois location is immaterial for purposes of local taxes if the sale occurs through order acceptance in an Illinois jurisdiction imposing a local tax. For these transactions the local tax will be incurred. Although 86 Ill. Adm. Code 270.115 deals with the municipal Home-Rule taxes, the principles outlined in this regulation apply to all local taxes administered by the Department.

If a purchase order is accepted outside the State, but the property being sold is located in an Illinois jurisdiction that has imposed a local tax (see, for example, Section 270.115(b)(3)), then the location of the property at the time of sale will determine where the seller is engaged in business for the purpose of determining the imposition of applicable local sales taxes.

In general, the purchase of tangible personal property at retail for use or consumption in this State is subject to Illinois Use Tax. See 35 ILCS 105/2 and 3. If the retailer does not collect the Use Tax from the purchaser for remittance to the Department, the purchaser is responsible for remitting the Use Tax directly to the Department. See 86 Ill. Adm. Code Section 150.130, enclosed for your reference. When property is purchased and then given away, the donor has made a taxable use of the property by making such gift. Therefore, it is the donor of the gift who is deemed the end user of the property and who is subject to the Use Tax, rather than the donee. See 86 Ill. Adm. Code Section 150.305(c), enclosed.

The donor's Use Tax liability is calculated on the cost price of the property given away. When the property is purchased at retail, the base for calculating Use Tax is the purchase price of the property. If, however, the property given away is a finished product produced by the donor, the donor's Use Tax liability is calculated on the donor's cost price of the materials and products purchased and incorporated into the finished product. See 86 Ill. Adm. Code Section 150.305(b) and (c).

Where florists conduct transactions through a florists' delivery association, the following rules will apply in the computation of tax liability (see 86 Ill. Adm. Code 130.1965):

- 1) On all retail orders taken by an Illinois florist and transmitted to a second florist in Illinois for delivery in this State, the sending florist will be held liable for Retailers' Occupation Tax with respect to the total amount which he collects from his customers, except for the cost of the message conveying delivery instructions where this item is charged for separately from the selling price of the flowers.
- 2) Where an Illinois florist receives an order pursuant to which he gives instructions to a second florist located outside Illinois for delivery of flowers to a point outside Illinois, tax will likewise be owing with respect to the receipts of the Illinois florist from the customer who placed the order.
- 3) Where Illinois florists receive instructions from other florists located either within or outside of Illinois for the delivery of flowers, the receiving florist will not be held liable for tax with respect to any receipts which he may realize from the transaction. In this instance, if the order originated in Illinois, the tax will be due from and payable by the Illinois florist who first received the order and transmitted instructions to the second florist.

A drop-shipment situation is one in which out-of-State purchasers (Purchasers) make purchases for resale from companies (Companies) which are registered with Illinois and have those Companies drop-ship the property to Purchasers' customers (Customers) located in Illinois. For this discussion, it is assumed that Purchasers are out-of-State companies that are not registered with the State of Illinois and do not have sufficient nexus with Illinois to require them to collect Illinois Use Tax.

As sellers required to collect Illinois tax, Companies must either charge tax or document exemptions when they make deliveries in Illinois. In order to document the fact that their sales to Purchasers are sales for resale, Companies are obligated by Illinois to obtain valid Certificates of Resale from Purchasers. See the enclosed copy of 86 Ill. Adm. Code 130.1405. Certificates of Resale must contain the following items of information.

1. A statement from the purchaser that items are being purchased for resale;
2. Seller's name and address;
3. Purchaser's name and address;
4. A description of the items being purchased for resale;
5. Purchaser's signature and date of signing;
6. Purchaser's registration number with the Illinois Department of Revenue; purchaser's resale number issued by the Illinois Department of Revenue; or, a statement that the

purchaser is an out-of-State purchaser who will sell only to purchasers located outside the State of Illinois.

If Purchasers have no nexus with Illinois, it is unlikely that Purchasers would be registered with Illinois. If that is the case, and if Purchasers have no contact with Illinois which would require them to be registered as out-of-State Use Tax collectors for Illinois, then Purchasers could obtain resale numbers which would provide them the wherewithal to supply required numbers to Companies in conjunction with Certificates of Resale. We hope the following descriptions of out-of-State sellers required to register, either as Illinois retailers or as out-of-State Use Tax collectors and persons who qualify for resale numbers will be useful.

Assuming a delivery in Illinois, Illinois retailers are anyone who either accepts purchase orders in Illinois or who sells items of tangible personal property which are located in Illinois at the time of sale. See the enclosed copy of 86 Ill. Adm. Code 130.605(a).

Out-of-State sellers who fall under the definition of a “retailer maintaining a place of business in this State” (see 86 Ill. Adm. Code 150.201(i), enclosed) must register to collect Illinois Use Tax from Illinois customers and remit that tax to the Department. See 86 Ill. Adm. Code 150.801(c), enclosed. Please note that out-of-State sellers with any kind of agent in Illinois (not just sales or lease agents) are required to register as out-of-State Use Tax collectors. If Company B has no contact with Illinois, it does not fall within the definition of a “retailer maintaining a place of business in this State,” and it need not register as an out-of-State Use Tax collector.

The United States Supreme Court in *Quill Corp. v. North Dakota*, 112 S.Ct. 1904 (1992), set forth the current guidelines for determining what nexus requirements must be met before a person is properly subject to a state’s sales tax laws. The Supreme Court has set out a two-prong test for nexus. The first prong is whether the Due Process Clause is satisfied. Due Process will be satisfied if the person or entity purposely avails himself or itself of the benefits of an economic market in a forum state. *Id.* at 1910. The second prong of the Supreme Court’s nexus test requires that, if due process requirements have been satisfied, the person or entity must have physical presence in the forum state to satisfy the Commerce Clause.

A physical presence does not mean simply an office or other physical building. Under Illinois tax law, it also includes the presence of any representative or other agent of the seller. The representative need not be a sales representative and it is immaterial for tax purposes that the representative’s presence is temporary.

Resale numbers are issued to persons who make no taxable sales in Illinois but who need the wherewithal to provide suppliers with Certificates of Resale when purchasing items that will be resold. So long as Purchasers do not act as Illinois retailers and, so long as they do not fall under the definition of a “retailer maintaining a place of business in this State”, their sales to Illinois customers are not subject to Illinois Retailers’ Occupation Tax liability and they cannot be required to act as Use Tax collectors. So long as this is true, Purchasers qualify for resale numbers that do not require the filing of tax returns with the Illinois Department of Revenue. See 86 Ill. Adm. Code 130.1415.

Please note that the fact that Purchasers may not be required to act as Use Tax collectors for Illinois does not relieve their Customers of Use Tax liability. Therefore, if Purchasers do not collect Illinois Use Tax from their Customers, the Customers would have to pay their tax liability directly to the Illinois Department of Revenue.

While active registration or resale numbers on Certificates of Resale are still preferred, the Illinois Retailers' Occupation Tax Act provides as follows:

"Failure to present an active registration number or resale number and a certification to the seller that a sale is for resale creates a presumption that a sale is not for resale. This presumption may be rebutted by other evidence that all of the seller's sales are sales for resale or that a particular sale is a sale for resale." 35 ILCS 120/2c.

Again, including registration or resale numbers from Purchasers on Certificates of Resale is the preferred method for documenting that their purchases from Companies are purchases for resale. However, in light of this statutory language, certifications from Purchasers on Certificates of Resale in lieu of resale numbers which described the drop-shipment situation and the fact that Purchasers have no contact with Illinois which would require them to be registered and that they choose not to obtain Illinois resale numbers would constitute evidence that this particular sale is a sale for resale despite the fact that no registration number or resale number is provided. The risk run by Companies in accepting such a certification and the risk run by Purchasers in providing such a certification is that an Illinois auditor is much more likely to go behind a Certificate of Resale which does not contain a valid resale number and require that more information be provided by Companies as evidence that the particular sale was, in fact, a sale for resale.

I hope this information is helpful. The Department of Revenue maintains a website, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b).

Very truly yours,

Melanie A. Jarvis
Associate Counsel

MAJ:msk
Enc.